Close Brothers
Asset Management

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Close Diversified Income Portfolio Fund

Monthly fund manager update

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PERFORMANCE

The Close Diversified Income Portfolio Fund rose 0.3% in June. A further month of positive performance means that the fund has recorded another all-time high Nest Asset Value (NAV). The return for the month compares to a 1.2% rise for the Investment Association Mixed Investment 20-60% Shares Sector.

Stock markets were up in June, with the U.S. particularly strong given the dollar's appreciation over the month. However, as the Fund's non-GBP exposure is half hedged it did not benefit from USD strength to the extent that un-hedged peers might. The U.S. market rose 2.2% (+5.1% in GBP terms), and the tech focussed NASDAQ rose 5.5% (+8.4% in GBP terms). European markets rose 0.6% (+0.4% in GBP terms), while the UK was up 0.2%. As one can see, equity returns were clearly skewed to the U.S. and technology stocks over the month.

Technology stocks and long dated bonds (the highest duration asset classes) had a positive month as it seems the market increasingly believes Central Bank forecasts that the inflation spike will be transitory, and that any monetary tightening to come will not slam the brakes on the economy nor be too behind the curve. This resulted in short dated interest rates rising but long dated interest rates falling; we remain positioned at the short end which underperformed this month. This goldilocks scenario also saw gold lose some of its lustre, and the Fund's position was a notable detractor to performance this month, with gold falling -7.2% in USD terms (-4.3% in GBP terms).

Long-time readers of the monthly commentary will be aware how placings can often depress share prices in the short-term, as the market price trends towards the issue price of the new shares. On the final day of the month, both International Public Partnerships (infrastructure) and Urban Logistics (warehouses) announced fund raises at discounted prices, which had a negative impact on the respective share prices. Phoenix Group also saw its share price come under pressure (-8%) in the month as Swiss Re announced it was placing 66 million shares, or half of its holding. Swiss Re became a minority shareholder in Phoenix after the 2019 deal to sell ReAssure to Phoenix Group but have now opted to sell down the shares they received after the lock-up ended. We participated in the placing and picked up some shares at 660p (a 7.3% yield) though it was heavily oversubscribed. We subsequently topped up the holding further at 670p (7.2% yield). Swiss Re can sell the rest of their holding in 3 months, so the shares may not bounce back straight away, and could even keep falling, but the Fund has scope to further increase the weighting should they decide to sell the final tranche at a discount as well. The shares were trading in a 710p-760p range in the months prior to Swiss Re selling at 660p. These share price falls are more due to technical factors rather than any fundamental change in the investment case so we would expect the price to recover in time, and, as such, these events can potentially be good buying opportunities.

The investment trusts continued their recovery from the 2020 falls with Residential Secure Income, GCP Infrastructure and GCP Asset Backed Income all moving to a premium to NAV once more.

The 10-year gilt yield fell to 0.72% from 0.80%. Corporate bond spreads declined to 1.28% from 1.33%, whilst riskier BB spreads reduced slightly to 2.61% from 2.62%. Bond spreads remain well below the long-term averages of 2.13% for BBB and 4.32% for BB. The Fund still has no allocation to Gilts, with the fixed income exposure is entirely in corporate bonds. Despite the high valuations in the bond space the weighting to bonds increased slightly in the month to 34.7% from 33.5% (see Portfolio Activity below). The bond portfolio has a yield of 3.2% and 4 years of duration. In May, Burford Capital announced a tender offer for its 2022 bonds and the results of this were revealed in June with just £28.65m of their bonds tendered (they were after £40m) despite paying the maximum price of 105p, a yield of just 2.08%.

PORTFOLIO ACTIVITY

BBGI Infrastructure was top-sliced again and UDG Healthcare was completely sold at 1048p (above the initial takeover bid of 1023p) as the day to vote on the proposed takeover deal by a US private equity group came. Both the company management and ISS (who provide research and guidance on how to vote to fund managers) were recommending that shareholders accept the bid at 1023p. Whilst we agreed with a couple of vocal shareholders that the

1023p bid was too low, we decided to sell in the market at a higher price, thereby hedging our bets on the three possible scenarios: 1) the deal was approved by shareholders at 1023p, leading to a small share price fall; 2) the bidder walked away leading to a large share price fall; or 3) the bidder put in a higher bid, leading to a share price rise. As it happened the shareholder vote was cancelled at the last minute and the bidder has since put in a final offer of 1080p. So in the end it looks like we missed out on 22p if the deal goes through, although the investment still made a decent return for the Fund since purchase.

We participated in the Cordiant Digital Infrastructure C share raise at 100p. We added to the Trafigura Perpetual bond (callable 2022) at yields of 4-4.5%. The bonds have rallied (pushing yields down to 3.5%) in the month as investors digested their record interim results, deleveraging and positive comments around a likely call of the bond in 2022 (we do not mind if they don't call it as the yield will go to 7.6% as the coupon resets). IPF 2025 was also added to at a 6.46% yield.

In the equity space a new holding was added in Beazley, an insurance and underwriting services group. We already hold Beazley bonds (this position was materially upweighted after their equity raise back in May 2020 which reduced the risk for bondholders), but given our multi-asset investment process we look at a name from both the equity and bond perspective. While the bonds have done very well and trade at new highs (11% capital gains since the May additions), Beazley's equity has been a poor performer since 2020, despite many other covid-impacted equities performing quite strongly – especially since November's vaccine-induced rally. This equity underperformance has left the shares looking historically lowly valued, be it on an earnings basis (almost decade lows), or the more commonly used price/book basis of measurement (1.5x multiple versus the long-term average of 1.8x). We see some light at the end of the tunnel as the Covid-19 insurance claims and cyber ransomware claims reduce (lower costs), coupled with significant rises in prices charged (higher margins), and better terms and conditions (lower risks taken on). As such, we would hope that profits should recover from here (assuming a normal patterns of claims). The return to profitability should allow the group to return to dividend paying ways in 2021 – which could also be a catalyst for the stock.

YIELD

The Fund's yield (based on end of month prices) was static at 3.6% with new investments helping to offset the impact from another month where the Fund's NAV rose. The cash weighting decreased to 10.2%. Having cash gives optionality and it will be invested in new ideas as they are identified, or when any market pull back makes valuations in general more attractive. The yield on the Fund is the result of all the individually picked attractive risk / reward ideas.

OUTLOOK

The Fund remains diversified by asset class, geography and sector with the purpose of generating attractive risk adjusted returns for clients. We will continue to tilt the portfolio away from areas and ideas that are more expensive, with lower forward-looking returns, and continue to use the Quant Model to focus research efforts on those areas and ideas with better value.

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